

## Credit Update

## African Development Bank

### Ratings

#### African Development Bank Foreign Currency

Long-Term	AAA
Short-Term	F1+
Outlook	Stable

Individual	-
Support	-

### Financial Data

#### African Development Bank

	31 Dec 2002	31 Dec 2001
Total Assets (USDm)	11,063.5	11,072.2
Total Assets (XDRm)	8,139.4	8,810.7
Equity (XDRm)	3,390.2	3,151.8
Net Income (XDRm)	226.1	207.7
Net RoA (%)	2.67	2.38
Net RoE (%)	6.91	6.84
Equity/Assets (%)	41.65	35.77
Available Equ./	685.7	613.1
Required Cap. (%)		

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### Rating Rationale

#### Assessment

- African Development Bank's (AfDB) ratings are primarily based on the support from its member countries, which include several highly-rated non-regional shareholders, the sound credit policies implemented in 1995 and its preferred creditor status, common to all Multilateral Development Banks (MDBs), which gives AfDB priority over other lenders.
- Since 1995, the Bank has been following conservative credit and financial policies. ALM, liquidity management and market activities are governed by a number of internal prudential ratios. Countries eligible for AfDB loans are restricted to the most solvent African countries. However, a large portion of its portfolio (30%) is still made up of pre-1995 loans, to countries no longer eligible for AfDB loans.
- Arrears are significant compared with other MDBs, due to the high risk profile of most African sovereign borrowers, and, more specifically, to the default of Zimbabwe and Côte d'Ivoire in 2000 and 2003 respectively. Impaired loans accounted for 14.3% of outstanding loans at end-2002, vs 19.9% in 2001. Arrears have decreased as a result of the arrears clearance scheme granted, in conjunction with the IMF, the World Bank and other bilateral and multilateral donors, to the Democratic Republic of Congo (Congo (Kinshasa)), which accounted for 60% of arrears in 2001. The bank has continued to build up its general reserves over the past few years, which amounted to 8.2% of loans at end-2002, covering 57.8% of impaired lending.
- Viable projects qualifying for AfDB funding are becoming scarce. To boost activity, the Bank has been developing private sector lending, which accounted only for 3.9% of its total portfolio at end-2002. Loans to the private sector have grown at a faster rate than sovereign loans in the last two years, and accounted for 22.6% of new approvals in 2002.
- Market risks are not significant, as the bank has an effective policy of hedging all interest and exchange rate exposure. Despite the long maturity of AfDB's loans (10 to 15 years), liquidity is excellent, as the Bank holds a large liquid assets portfolio, composed of top grade financial investments.
- AfDB capitalisation is one of the highest among the MDBs, as is shown by the ratio of available equity to required capital, which stood at 685.7% in 2002.

#### Support

- AfDB's capital is held by 77 member countries, 53 of which are African. Fitch Ratings views the amount of uncalled subscribed capital that highly-rated non-African countries are liable to provide as a principal factor supporting the Bank's ratings. The in-depth reforms AfDB has implemented since 1997 have restored non-regional shareholders' confidence, as illustrated by the 35% capital increase in 1999, which took the share of non-African members' holdings to 40% from 33%.

#### Background

- The AfDB is a MDB created to aid the economic and social development of its regional members, and to finance infrastructure projects and welfare measures on the African continent. Based in Abidjan (Côte d'Ivoire), the Bank employed 1,028 people at the end of 2002. In 2003, following the civil war that broke out in Côte d'Ivoire, the Bank's staff have been relocated to Tunis.
- AfDB makes loans directly to governments, on a project finance basis or in connection with aid packages granted by the IMF and other multilateral institutions. It is also involved, to a lesser extent, in private sector lending, including direct equity investments. Some 15 African countries are eligible for AfDB loans. Non-eligible states can have access to concessional resources through the African Development Fund (ADF) and the Nigerian Trust Fund (NTF), both of which are managed by AfDB but are financially independent.

## ■ PROFILE

### Historical Background

The African Development Bank is a Multilateral Development Bank (MDB) established in 1964 with headquarters in Abidjan (Côte d'Ivoire), with the mission of promoting economic and social development of its regional member countries. The Bank's President, M. Omar Kabbaj, from Morocco, was appointed in 1995, in the aftermath of a deep institutional crisis, which led to the departure of the previous management team and seriously undermined the credibility of the Bank. Mr Kabbaj implemented comprehensive reforms of the bank's credit and financial policies and a major management reshuffle. Some 70% of the executives were replaced between 1995 and 1997 in an effort to attract top-level bank executives. These reforms restored shareholders' confidence, which led to a capital increase in 1999, the fifth in the bank's history), as well as replenishing (the ninth) the African Development Fund (ADF) in 2001. Negotiations for the tenth replenishment of the ADF are planned to commence in 2004. In 2002, the growing political instability in Côte d'Ivoire turned into civil war, and forced the AfDB to relocate its headquarters to Tunis (Tunisia). This relocation is only a temporary arrangement, and the Bank has decided to maintain its official head office in Abidjan. The situation will be reassessed by the Board of Governors in 2004 with a view to returning to Abidjan in 2005 if the result of the review is satisfactory.

### Organisation

The Bank employed 1,028 people at the end of 2002. Each member country of the AfDB appoints a governor to the Board of Governors, the ultimate decision-taking body. Among other things, the Board approves capital increases, the admission of new members and defines the Bank's strategy. The Bank has an 18-member resident Board of Directors, representing the 77 member countries, which oversees operations and policy-making. Six directors represent non-African countries. Decisions are taken on the basis of a two-thirds majority. However, members have the right to request the application of a 70% weighted majority. The Bank's president is responsible for day-to-day management and is elected by the Board of Governors for a term of five years (maximum of two terms).

### Activities of AfDB Group

The AfDB Group provides development financing and technical assistance to its regional member countries. Funds are channelled through three routes: the AfDB, whose loans are reserved for the 15 countries currently eligible, the ADF and the

Nigerian trust Fund (NTF), which grant concessional loans to countries not able to borrow from the AfDB. The latter two have access to concessional resources subscribed by donor countries and grants loans under extremely favourable conditions. While managed by the AfDB, ADF and NTF are financially autonomous.

In 2002, financing approved by the Bank (UA<sup>1</sup>1,068.1m) represented 52.4% of the Group's total lending, with the ADF financing the bulk of the balance; the share of the NTF in total financing is marginal. AfDB commitments take various forms:

### AfDB Approvals by Instrument (1998-2002)

(UAm)	2002	2001	2000	1999	1998
Project Loans	689.9	568.4	402.2	570.1	362.7
Public	491.0	376.4	375.0	472.7	306.6
Private	198.9	192.0	27.2	97.4	56.1
Equity investments	-	-	2.3	4.7	56.0
Policy-Based Loans	185.6	232.1	-	198.0	227.2
<b>Total Direct Financing</b>	<b>875.5</b>	<b>800.5</b>	<b>404.6</b>	<b>772.8</b>	<b>645.9</b>
HIPC* Debt Relief	188.0	174.9	173.9	20.8	22.1
Guarantees & Other	4.6	11.3	264.7	0.7	-
<b>Total</b>	<b>1,068.1</b>	<b>986.7</b>	<b>843.2</b>	<b>794.3</b>	<b>668.0</b>

\* Heavily Indebted Poor Countries  
Source: AfDB annual report

Fitch distinguishes direct financing (loans and equity injections) from those forms of financing that are not recorded as assets in the Bank's balance sheet, ie debt relief – financed by the HIPC (Heavily Indebted Poor Countries) Trust Fund, internal resources – and guarantees, which are recorded off-balance sheet. Project loans are the AfDB's principal product, representing 78.8% of direct financing in 2002. They are channelled into agriculture, utilities, transport, industry, health and education. They are mainly to the state, which manages directly or guarantees the project in question, to public entities or state-controlled banks (which in turn allocate the funds to various projects). Disbursements are spread over the project's life. The bank reserves the right to suspend disbursement if the debtor falls behind on repayments, and can cancel undisbursed loans balances for non-performing projects. In addition, it has introduced a sanctions policy in the case of late payment (more than one month). A number of projects (31 in 2002, including ADF financing, totalling UA4.11billion) are co-financed, generally

<sup>1</sup> UA: Unit of account; 1 UA = 1 SDR (Special Drawing Rights (XDR) (= 1.37 USD in 1999)

with local financial institutions and other MDBs, mainly the World Bank; in 2002, the Bank's contribution amounted to 9.2% of the cost of those projects.

Financing to the private sector is now a strategic priority for the AfDB, having increased significantly in the last two years, and represented 22.7% of direct financing approved in 2002, their highest level since the establishment of the Bank. Financing takes the form of project financing (11.2% of total in 2002), credit lines (11.5%) granted to local banks, or equity participation; the latter type of intervention has not been used in the last two years.

Policy-based loans are credit facilities extended to finance clearly identified reforms in regional member countries. Approvals in 2001 included the liberalisation of the communications sector in Morocco and the development of the private sector in Tunisia. They can also be offered in the context of aid packages for African countries in difficulty. These loans are co-financed by other multilateral institutions – the World Bank, the EU, the IMF – and their disbursement is conditional on the implementation of the adjustment policies advocated by the multilaterals.

Debt relief granted in the context of the enhanced HIPC Initiative remained stable year-on-year in 2002 (UA187.9m compared with UA174.9m in 2001). The HIPC Initiative is an agreement reached in 1996 between the AfDB's borrowers, governments of developed countries and creditors to alleviate the debt burden of eligible countries. Debt relief is conditional on the borrowing countries implementing sound financial and economic policies. An enhanced framework was approved in 1999 to provide faster and deeper debt relief. Debt relief is being financed through a trust fund, to which donors and MDBs contribute. The HIPC Initiative will cost the MDBs an estimated USD14bn in net present value (NPV) terms, of which the AfDB Group's share will total USD3.07bn (including debt relief granted to Democratic Republic of Congo under the arrears clearance mechanism approved in 2002). However, a large portion will come from donors' funds. The actual cost for the Group will be USD370m, of which USD124m (less than 5% of equity) will arise from net income allocation from ADB, over the life of the HIPC Initiative and the remainder funded through the ADF reflows and loan cancellations. At end-2002, 22 countries reached their "decision point" under the HIPC Initiative; the Bank has approved debt relief to those countries, for a total amount of USD2.2m in nominal terms and USD1.6m in net present value (NPV). Six more countries, including Democratic Republic of Congo

(Kinshasa), may qualify this year and in 2004, which will add some USD1.2bn to the total. However, one of the conditions for HIPC eligibility is the clearance of all the arrears to the Bank. As of end-September 2003, only the Democratic Republic of Congo (Kinshasa) had cleared its arrears (see **Credit Risk**). Once approval has been decided, countries must demonstrate their ability to pursue sound economic policies during an interim period of 2-4 years before the debt relief process becomes irrevocable at the "completion point". At end-September 2003, seven countries had reached "completion point", ie they actually received the debt relief: Benin, Burkina Faso, Mali, Mauritania, Mozambique, Tanzania and Uganda.

## ■ CAPITAL, FUNDING AND LIQUIDITY

### Capital

Some 60% of the bank's capital is owned by the 53 African member states, with the remainder held by 24 non-regional member countries. Nigeria, Egypt and South Africa are the AfDB's largest African shareholders. In 1999, the bank's authorised capital increased by 35% to UA21.9bn, with the non-regional members' stake rising from one-third to 40%. The latter therefore hold a blocking minority in the Board of Governors' General Assembly, where a majority of two-thirds is required. At end-2002, subscribed capital totalled USD21.5bn, unchanged from 2001, as the quasi-totality of the shares issued under GCI V were subscribed.

### AfDB's 10 Largest Shareholders at End-2002 (%)

<b>Total Non-African Countries</b>	<b>40.40</b>
USA	6.73
Japan	5.55
Germany	4.16
France	3.79
Canada	3.79
<b>Total African Countries</b>	<b>59.60</b>
Nigeria	8.91
Egypt	5.12
South Africa	4.22
Algeria	3.81
Côte d'Ivoire	3.66
<b>Total</b>	<b>100.00</b>

Source: AfDB annual report

As with other MDBs, the bank's paid-in capital is a fraction of subscribed capital. Following 1999's capital increase, the portion of paid-in capital in the newly-subscribed capital has been reduced to 9.8% of subscribed capital, from 12.5% previously. At end-2002, subscribed capital consisted of UA2.1bn in paid-in capital and UA19.4bn of subscribed but uncalled capital, or callable capital. The increase in

paid-in capital is payable in eight equal annual installments; at end-2002, some countries were still in arrears on capital payments, totalling UA10m, a significant reduction on 2001 (UA18m).

Fitch views callable capital as a form of shareholder guarantee that can be utilised if necessary. It is included by the AfDB when calculating its lending capacity, defined by the Bank's policy as a maximum 80% of callable capital. In addition, the Bank also consistently applies a more conservative measure of borrowing capacity, which is 100% of "usable capital". Usable capital is defined as equity plus callable capital subscribed by countries rated 'AA' and above. Like other MDBs, the AfDB is not subject to international banking regulation. However, it has set its own measures of capital adequacy and leverage, based on three ratios:

### Afdb's Internal Prudential Ratios

Ratio (%)	Max.	2002	2001	2000
Total Debt/Usable Capital*	100.0	47.9	50.9	54.7
Total Debt/Callable Capital	80.0	23.0	26.9	29
Senior Debt/Callable Capital from Non-Borrowing Countries	80.0	41.7	44.2	46.9

\* Usable capital = Callable capital from 'AA/AAA' rated countries + Paid-in capital + Reserves  
Source: AfDB annual report

In recent years, capital and leverage ratios have benefited from the combined effect of the 1999 capital increase and the contraction in lending volumes, which led to a reduction in the capital requirement and in debt funding. In the future, these ratios will continue to improve, albeit at a slower pace, as capital instalments are paid up by shareholders.

### Capital Adequacy Measures (Fitch Definition)

	2002	2001	2000
Authorised Capital (UAm)	21,870	21,870	21,870
Subscribed Capital (UAm)	21,510	21,491	20,548
Callable Capital (UAm)	19,376	19,395	18,531
Paid-in Capital (UAm)	2,135	2,096	2,017
Equity (UAm)	3,390	3,152	2,924
Usable Equity (UAm)	10,599	10,361	9,943
Available Equity (UAm)	18,619	18,387	17,342
Required Capital (UAm)	2,715	2,999	2,846
Usable Capital/Required Capital (x)	3.90	3.46	3.49
Available Equity/Required Capital (x)	6.857	6.131	6.094

Source: AfDB annual report; FitchRatings

To compare the solvency of all MDBs, the agency has developed its own capital adequacy measures (see Risk Analysis of Multilateral Development Banks, March 1999, available on [www.fitchratings.com](http://www.fitchratings.com)), based on analysis of credit quality of both borrowers and shareholders. It computes required capital to cover the Bank's credit risk and compares it with available equity (paid-in capital, reserves and a portion of callable capital). The AfDB's ratio of available equity to required capital is one of the highest in the MDB industry. It has been steadily improving in recent years, reflecting the strengthening of the Bank's equity.

### Funding

Like other MDBs, the AfDB does not accept deposits; it uses predominantly capital market funding, which is cheaper than interbank borrowing, owing to the excellent conditions at which it can raise funds. The Bank's funding policy follows the above-mentioned prudential limits regarding leverage. The Bank has set working guidelines regarding subordinated debt, which should not exceed 40% of total debt, although this does not constitute a Board approved limit. In the past, the AfDB had made quite extensive use of subordinated debt, constituting 20.1% of total borrowings at end-2002 (27.6% in 2001). The Bank's borrowings are predominantly denominated in US dollars (USD) (49.4% of total borrowings at end-2002), in euros (EUR) (24.2%) and Japanese yen (JPY) (20.2%). The average maturity was 8.7 years at end-2002. It has established a EUR1bn commercial paper programme, which remained unused in 2002. The Bank's funding strategy is opportunity driven, and aims at facilitating the matching of assets and liabilities while reducing borrowing costs. The AfDB's funding costs have been decreasing as a result of declining interest rates and AfDB's lower spreads on its bond issues; its average cost of borrowing, after swapt, was 5.00% in 2002, vs 6.21% in 2001.

### Liquidity

The AfDB is a highly-liquid bank, thanks to its portfolio of liquid assets, made up of high quality debt securities and bank deposits, which amounted to UA2.2bn at end-2002, or 27.0% of total assets. The portfolio consists predominantly of securities held to maturity (53.0% at end-2002) and trading securities (36.0%), the remainder being held in bank accounts. Liquid assets are invested in hard currencies, in particular USD, EUR, and pounds sterling (GBP). The liquidity reserve serves not only to provide readily available resources to meet daily cash requirements, but also to fund loan commitments when access to financial markets is difficult.

The Bank's liquidity policy requires that liquid assets be at least equal to the loan equivalent value of guarantees and undisbursed equity investments and private sector loans, plus 50% of the following two years' net loan disbursements and debt servicing requirements. The ceiling is set at the prudential minimum plus 50% of average undisbursed loans for the following two years. In addition, the bank cannot invest in placements rated lower than 'AA-'; the limit is set at 'A' for money market instruments. Asset-backed securities are restricted to 'AAA' rated bonds.

## ■ RISK

### Credit Risk

#### AfDB's 10 Largest Sovereign Exposures (2001-2002)

	2002		2001	
	UAm	%	UAm	%
Tunisia**	1,107.3	18.6	1,098.2	14.9
Morocco**	911.7	15.3	1,106.6	16.8
Algeria**	753.0	12.6	783.1	11.3
Nigeria*	568.8	9.5	635.1	10.7
Côte d'Ivoire	352.3	5.9	429.0	6.9
Congo (Kinshasa)	347.9	5.8	343.5	5.4
Egypt**	242.7	4.1	340.0	5.5
Gabon**	219.9	3.7	230.4	4.2
Zimbabwe*	204.0	3.4	212.0	3.2
Republic of Congo (Brazzaville)	138.0	2.3	139.0	2.2
<b>Sub-Total</b>	<b>4,845.6</b>	<b>81.2</b>	<b>5,316.9</b>	<b>81.3</b>
Other	1,122.1	18.8	1,148.9	18.7
<b>Total</b>	<b>5,967.7</b>	<b>100.0</b>	<b>6,465.8</b>	<b>100.0</b>

\* Countries eligible for both AfDB and ADF loans

\*\* Countries eligible for AfDB loans

Source: AfDB annual report

The AfDB advances loans predominantly to sovereigns; private sector exposure represented 3.9% of total financing (ie loans plus equity participations) at end-2002. African countries' overall credit quality is poor: 32 countries out of 53 are eligible for debt relief under the HIPC Initiative, which suggests that their debt burdens are considered unsustainable by the IMF. Arrears are high, reflecting a deterioration of the Bank's loan portfolio in the 1990s: at end-2002, only one (Tunisia) of the 10 largest borrowers was rated investment grade. This was due to the absence of a more stringent credit policy until 1995, which allowed loans to be granted to all borrowing member countries irrespective of their risk profiles. Furthermore, insufficient project monitoring strained relations between shareholders and management, resulting in an increase in loan arrears as many Sub-Saharan African countries were faced with deteriorating economies or political instability. Since the introduction of the current credit policy in 1995,

the bank loans are restricted to 13 countries<sup>2</sup>, referred to as eligible, while the remaining countries have access to concessional financing from the ADF; two countries (Nigeria and Zimbabwe) can seek loans from both the AfDB and ADF.

As is the case for other MDBs, AfDB's lending is highly concentrated, with the 10 largest exposures representing 81.2% of its loan portfolio at end-2002. Northern African borrowers dominate (50.6% of outstanding loans at end-2002); their creditworthiness deemed among the highest on the continent, with Tunisia rated investment grade. However, exposure to Southern African countries is growing as the credit quality of a number of countries in this region has improved since the late-1990s. A system of country limits, applicable to both AfDB and ADF loans, based on creditworthiness, was introduced in 1997 to manage concentration risk.

High credit risk is mitigated by the AfDB's preferred creditor status on public sector loans, which gives it priority over other creditors in the event of a sovereign default. In addition, like other MDBs, the Bank applies stringent rules when principal or interest are more than 30 days overdue, by halting disbursement of AfDB and ADF loans. Loans in arrears for more than six months are considered in non-accrual status, whereby interest accruals are suspended and interest due reversed. The AfDB does not, however, build specific loan loss provisions, with the exception of private sector loans, but instead sets aside general provisions. This policy could be changed with the implementation of IAS39 accounting rules.

Despite a strict credit policy, loans in arrears have increased since the mid-1990s, primarily resulting from loans granted prior to 1995, to countries in conflict situations and in chronic arrears, such as Democratic Republic of Congo (Kinshasa), Congo (Brazzaville), Liberia and Sudan. The other main factor explaining the rise in arrears since 2000 was the default of two large borrowers, Zimbabwe and Côte d'Ivoire. As principal and interest payments fall due, these massive arrears have continued to build-up, peaking at 24.6% of total loans in 2000, which is the highest ratio of arrears to outstanding loans of all MDBs. This trend was reversed in 2002, principally as a result of an arrears clearance mechanism that was implemented for Democratic Republic of Congo (Kinshasa), whereby contributions received by donors were used to clear this country's arrears, and

<sup>2</sup> Algeria, Botswana, Egypt, Equatorial Guinea, Gabon, Libya, Mauritius, Morocco, Namibia, Seychelles, South Africa, Swaziland and Tunisia.

reduce the principal amount of its debt to an amount considered sustainable. This measure is exceptional, and is motivated by the profound political troubles that this country has faced in the last decade and the magnitude of its arrears. In addition, as a measure of prudence, Democratic Republic of Congo (Kinshasa)'s debt is still maintained in non-accrual status. Côte d'Ivoire also cleared its arrears in 2002. However, civil war resumed at end-2002, which translated into liquidity problems; as of mid-2003, the country was not current on its debt to the AfDB and has therefore returned to non-accrual status.

### Sovereign Loans with a Non-Accrual Status (2000-2002)

(UAm)	2002	2001	2000
Angola	-	-	26.7
Burundi	6.8	7.3	4.8
Central African Republic	2.4	3.2	3.0
Comoros	6.4	10.5	9.9
Congo (Brazzaville)	138.0	77.2	61.7
Côte d'Ivoire	-	44.5	28.5
Congo (Kinshasa)	347.9	600.8	569.4
Gabon	-	-	29.9
Liberia	41.6	114.6	110.0
Seychelles	20.0	7.8	3.5
Somalia	3.7	7.8	7.6
Sudan	59.6	45.4	38.2
Zimbabwe	204.0	80.5	32.8
Others	-	5.5	7.5
<b>Total</b>	<b>830.4</b>	<b>1,005.0</b>	<b>933.5</b>

Source: AfDB's annual report

The partial clearance of Democratic Republic of Congo's arrears had the effect of substantially reducing loans in non-accrual status in 2002. The principal amount of such loans – public and private – declined from UA1,286.0m in 2001 to UA851.4m in 2002, despite the build-up in arrears from Zimbabwe. The implementation of the HIPC Initiative is expected to have a favourable impact on arrears, as it will grant qualified countries debt relief, representing up to 80% of debt service. Democratic Republic of Congo, which accounts for 42% of non-accruals loans, could qualify for HIPC debt relief in the short term, and could be followed by the Congo (Brazzaville) (17% of non-accruals loans), as well as Burundi, the Comoros and Central African Republic. The process could take longer for Liberia, Somalia and Sudan. The "decision point" has been postponed for Côte d'Ivoire, owing to the deterioration of the political situation this year. Zimbabwe's situation in the short term is not expected to improve, and the country accounted for 25% of non-accrual loans in 2002, a ratio which is expected to continue to increase in 2003 and 2004.

Private sector loans and equity participations present a greater risk than public sector loans, where

preferred creditor status does not apply. Private sector loans represented some 2.6% of accumulated loan loss provisions at end-2002. Although they are on a rising trend, they still only represented 2.8% of outstanding loans at end-2001; credit lines to local banks represent a sizeable portion of the total (50.5% of approved private sector loans in 2002). The bank restricts its commitments to private projects to one-third of total financing. Equity participations equated to 1.2% of total commitments at end-2002 and were 25.7% covered by provisions; shares in local development banks account for one-third of the total. The Bank's exposure to the private sector will continue to increase in the future, through direct loans and equity stakes.

### Non-Accrual Status Loans and Provisions (1998-2002)

(UAm)	2002	2001	2000	1999	1998
Non-Accrual Loans	851	1,286	1,620	981	967
Balance Sheet Provisions	492	494	422	387	351
Non-Accrual Loans/Loans %	14.3	19.9	24.6	14.4	14.9
LL Reserves/Loans %	8.2	7.6	6.4	5.7	5.2
LL Reserves/Non-Accrual Loans %	58	38	26	39	37

Source AfDB's annual report

The level of provisioning for non-accrual loans has improved in the last two years. The Bank has steadily increased its general and specific provisions since 1995, bringing loan loss reserves to 8.2% of gross loans at end-2002. The coverage of non-accrual loans, which was one of the lowest among the MDBs, improved sharply in 2002 as a result of the reduction in arrears.

### Market Risk

Since 1995, the bank has had a match-funded policy through ALM (asset and liability management) procedures, the objective being to mitigate market risk exposure. Borrowings are made in or swapped into the currency used to make loans to avoid exchange risk. Interest rate risk is also well controlled: all new lending is at floating rate and since 1998, when it swapped its outstanding fixed rate debt into floating, the AfDB has funded itself at floating rates, or at a fixed rate immediately swapped into floating. The Bank's equity resources are used to fund old fixed-rate loans, while a pool of fixed-rate debt funds the variable-rate loans on a cost-pass-through basis.

Interest rate and counterparty risks on the liquidity portfolio are limited. Liquid assets consist of top

grade investments whose benchmark is linked to LIBOR rates in individual currencies. The maximum portfolio duration allowed for liquid assets has been set at one year.

### **Operational Risk**

Owing to the disruptions caused by the civil war in Côte d'Ivoire, the staff of the Bank were relocated to Tunis this year. The Bank has maintained its back-up office that was set-up in Paris to ensure the protection of its data and the continuity of its operations, especially the servicing of its external debt obligations and payments to its creditors. These facilities proved their effectiveness during the period of political turmoil in 2000, when the Bank's main office in Abidjan was closed for one week.

### ■ **PERFORMANCE AND PROSPECTS**

The AfDB presents its accounts in accordance with International Accounting Standards (IAS). In 2001, the bank adopted IAS39, "Financial Instruments Recognition and Measurement", which requires that all derivative instruments be accounted at fair value. Like other MDBs, profitability is not one of the AfDB's primary objectives. However, improving profitability is a means of increasing its equity base, build up reserves and, thus, further enhance its development capacity and credibility.

### **Performance**

The 9.2% increase in earnings achieved by the AfDB in 2002 reflects the improvement in the Bank's asset quality, which translated into a reduction in arrears and in non-accrual loans. As a consequence, between 2001 and 2002, provisions charges were substantially cut – from UA53.8m to UA3.5m – and non-accrued interest was reduced from UA73.6m to UA33.4m. This counterbalanced the negative effect of the continuing decline in interest rates. Like other MDBs, the AfDB has been affected by the downward trend in interest rates, which directly affects the income from its liquid assets portfolio: investments yielded 3.89% in 2002, compared with 4.93% in 2001, which translated into a 39.0% reduction in revenues from this portfolio.

The fall in interest rates had no impact on the Bank's income from banking operations, as loans and borrowings carry floating rates. The slight reduction in net interest revenues in 2002 (-0.5%) is a consequence of the shrinking public sector loan

portfolio, which has not been offset by the increase in private sector lending. Expenses are well controlled, as shown by the stability of the non-interest expenses to revenues ratio. However, the AfDB's personnel and administrative costs increased significantly in 2002 (10.0% compared with 2001).

### **Prospects**

Since 2001, the declining trend in lending approvals and disbursements, subsequent to the more conservative credit policy introduced in 1995, has been reversed. Loans and equity investment approvals increased by 9.9% in 2002, with 22 projects approved, mostly directed to the financial and infrastructure sectors, and two policy-based loans. Private sector lending continued to rise (+3.6%), but no new equity stake was taken in 2002. However, the Bank's loan portfolio continued to shrink in 2002 (-7.7%), owing to a marked increase in loan repayments, which doubled from 2001. This also reflects difficulties in identifying viable projects that fit the Bank's self-imposed risk constraints, as well as increasing competition from the World Bank and other multi and bilateral agencies.

### **Approved Loans and Disbursement, (1997-2002)**

(UAm)	1997	1998	1999	2000	2001	2002
Appr - Direct Financing*	591	646	773	405	801	880
Disbursements	686	437	511	410	485	500

\* Does not include HIPC debt relief and guarantees  
Source: AfDB's annual report

The Bank will have difficulties in achieving its objective of increasing its loan portfolio by UA1bn by 2005, despite stronger growth in its private lending operations and efforts to widen its product range. The development of guarantees and market-related activities have not been very successful. On the other hand, the HIPC Initiative, while improving the risk profile of the Bank, has had a negative effect on the size of its portfolio and reduces the future flow of interest revenues. Private sector lending appears to be one of the Bank's key areas of growth; the Board has recently approved a new policy allowing the Bank to extend loans to private borrowers in countries where public entities are not eligible for AfDB loans. However, this may lead to a deterioration of the institution's risk profile.

BALANCE SHEET ANALYSIS	31 Dec 2002	31 Dec 2002			31 Dec 2001				31 Dec 1999	
AFRICAN DEVELOPMENT BANK	YEAR END	YEAR END	AS % OF	AVERAGE	YEAR END	AS % OF	YEAR END	AS % OF	YEAR END	AS % OF
	USDm	XDRm	ASSETS	XDRm	XDRm	ASSETS	XDRm	ASSETS	XDRm	ASSETS
<b>A. LOANS</b>										
1. Loans made through Banks	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. To/Guaranteed by Public Institutions	7,882.0	5,798.8	71.24	6,093.3	6,387.8	72.50	6,515.8	75.17	6,761.7	74.25
3. To Private Sector	229.6	168.9	2.08	123.5	78.0	0.89	49.8	0.57	28.6	0.31
4. Trade Financing Loans	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
5. Other Loans	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
6. Loan Loss Reserves (deducted)	668.3	491.7	6.04	492.9	494.2	5.61	421.5	4.86	387.4	4.25
<b>TOTAL A</b>	<b>7,443.3</b>	<b>5,476.0</b>	<b>67.28</b>	<b>5,723.8</b>	<b>5,971.6</b>	<b>67.78</b>	<b>6,144.1</b>	<b>70.88</b>	<b>6,402.9</b>	<b>70.31</b>
<b>B. OTHER EARNING ASSETS</b>										
1. Deposits with Banks	n.a.	n.a.	-	n.a.	n.a.	-	0.0	0.00	243.8	2.68
2. Securities held for Sale & Trading	1,095.1	805.7	9.90	1,452.5	2,099.2	23.83	1,822.2	21.02	897.5	9.86
3. Investment Debt Securities - (incl. other invest.)	1,595.4	1,173.7	14.42	n.a.	n.a.	-	n.a.	-	n.a.	-
4. Equity Investments	222.6	163.8	2.01	161.7	159.6	1.81	165.0	1.90	159.6	1.75
<b>TOTAL B</b>	<b>2,913.1</b>	<b>2,143.2</b>	<b>26.33</b>	<b>2,201.0</b>	<b>2,258.8</b>	<b>25.64</b>	<b>1,987.2</b>	<b>22.93</b>	<b>1,300.9</b>	<b>14.29</b>
<b>C. TOTAL EARNING ASSETS (A+B)</b>	<b>10,356.4</b>	<b>7,619.2</b>	<b>93.61</b>	<b>7,924.8</b>	<b>8,230.4</b>	<b>93.41</b>	<b>8,131.3</b>	<b>93.81</b>	<b>7,703.8</b>	<b>84.60</b>
<b>D. FIXED ASSETS</b>	<b>22.2</b>	<b>16.3</b>	<b>0.20</b>	<b>17.1</b>	<b>17.9</b>	<b>0.20</b>	<b>14.9</b>	<b>0.17</b>	<b>13.7</b>	<b>0.15</b>
<b>E. NON-EARNING ASSETS</b>										
1. Cash and Due from Banks	121.2	89.2	1.10	91.1	93.0	1.06	52.1	0.60	126.0	1.38
2. Other	563.7	414.7	5.09	442.1	469.5	5.33	469.8	5.42	1,262.6	13.87
<b>F. TOTAL ASSETS</b>	<b>11,063.5</b>	<b>8,139.4</b>	<b>100.00</b>	<b>8,475.1</b>	<b>8,810.8</b>	<b>100.00</b>	<b>8,668.1</b>	<b>100.00</b>	<b>9,106.1</b>	<b>100.00</b>
<b>G. SHORT-TERM FUNDING</b>										
1. Bank Borrowings (< 1 Year)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. Securities Issues (< 1 Year)	674.9	496.5	6.10	1,006.1	1,515.6	17.20	676.5	7.80	427.1	4.69
3. Other (incl. Deposits)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
<b>TOTAL G</b>	<b>674.9</b>	<b>496.5</b>	<b>6.10</b>	<b>1,006.1</b>	<b>1,515.6</b>	<b>17.20</b>	<b>676.5</b>	<b>7.80</b>	<b>427.1</b>	<b>4.69</b>
<b>H. OTHER FUNDING</b>										
1. Bank Borrowings (> 1 Year)	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. Other Borrowings (incl. Securities Issues)	4,162.4	3,062.3	37.62	2,658.8	2,255.2	25.60	3,008.0	34.70	3,105.8	34.11
3. Subordinated Debt	1,218.2	896.2	11.01	1,168.3	1,440.4	16.35	1,699.6	19.61	1,695.3	18.62
4. Hybrid Capital	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
<b>TOTAL H</b>	<b>5,380.6</b>	<b>3,958.5</b>	<b>48.63</b>	<b>3,827.1</b>	<b>3,695.6</b>	<b>41.94</b>	<b>4,707.6</b>	<b>54.31</b>	<b>4,801.1</b>	<b>52.72</b>
<b>I. OTHER (Non-Int Bearing)</b>	<b>399.9</b>	<b>294.2</b>	<b>3.61</b>	<b>371.0</b>	<b>447.8</b>	<b>5.08</b>	<b>360.4</b>	<b>4.16</b>	<b>1,113.9</b>	<b>12.23</b>
<b>J. GENERAL PROVISIONS &amp; RESERVES</b>	<b>n.a.</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>
<b>L. EQUITY</b>										
1. Preference Shares	n.a.	n.a.	-	n.a.	n.a.	-	n.a.	-	n.a.	-
2. Subscribed Capital	29,237.3	21,509.9	264.27	21,500.5	21,491.0	243.92	20,547.9	237.05	16,759.5	184.05
3. Callable Capital	-26,336.1	-19,375.5	-238.05	-19,385.3	-19,395.2	-220.13	-18,531.1	-213.79	-14,781.3	-162.32
4. Arrears/Advances on Capital	-283.8	-208.8	-2.57	-209.6	-210.4	-2.39	-363.4	-4.19	-431.0	-4.73
5. Paid in Capital (memo)	2,901.5	2,134.6	26.23	2,115.3	2,096.1	23.79	2,017.0	23.27	1,978.2	21.72
6. Reserves (incl. Net Income for the year)	1,990.8	1,464.6	17.99	1,365.5	1,266.4	14.37	1,270.2	14.65	1,216.8	13.36
<b>TOTAL L</b>	<b>4,608.1</b>	<b>3,390.2</b>	<b>41.65</b>	<b>3,271.0</b>	<b>3,151.8</b>	<b>35.77</b>	<b>2,923.6</b>	<b>33.73</b>	<b>2,764.0</b>	<b>30.35</b>
<b>M. TOTAL LIABILITIES &amp; EQUITY</b>	<b>11,063.5</b>	<b>8,139.4</b>	<b>100.00</b>	<b>8,475.1</b>	<b>8,810.8</b>	<b>100.00</b>	<b>8,668.1</b>	<b>100.00</b>	<b>9,106.1</b>	<b>100.00</b>
Exchange Rate				USD1 = XDR 0.7357	USD1 = XDR 0.7957		USD1 = XDR 0.7649		USD1 = XDR 0.7294	

INCOME STATEMENT ANALYSIS	31 Dec 2002		31 Dec 2001		31 Dec 2000		31 Dec 1999	
	INCOME EXPENSES XDRm	AS % OF TOTAL AV EARNING ASSTS	INCOME EXPENSES XDRm	AS % OF TOTAL AV EARNING ASSTS	INCOME EXPENSES XDRm	AS % OF TOTAL AV EARNING ASSTS	INCOME EXPENSES XDRm	AS % OF TOTAL AV EARNING ASSTS
<b>AFRICAN DEVELOPMENT BANK</b>								
1. Interest Received	463.0	5.84	555.0	6.78	511.3	6.46	506.9	6.49
2. Interest Paid	254.3	3.21	345.2	4.22	334.7	4.23	336.1	4.30
3. NET INTEREST REVENUE	208.7	2.63	209.8	2.56	176.6	2.23	170.8	2.19
4. Other Operating Income	20.2	0.25	9.8	0.12	11.4	0.14	14.7	0.19
5. Other Income	82.8	1.04	74.5	0.91	65.7	0.83	60.9	0.78
6. Personnel Expenses	93.9	1.18	85.7	1.05	79.8	1.01	76.0	0.97
7. Other Non-Interest Expenses	25.4	0.32	23.3	0.28	18.0	0.23	18.0	0.23
8. Loan Loss Provisions	3.5	0.04	59.7	0.73	39.1	0.49	28.9	0.37
9. Other Provisions	n.a.	-	n.a.	-	n.a.	-	n.a.	-
10. OPERATING PROFIT	188.9	2.38	125.4	1.53	116.8	1.48	123.5	1.58
11. Exceptional Items	37.2	0.47	82.3	1.01	n.a.	-	n.a.	-
12. NET INCOME	226.1	2.85	207.7	2.54	116.8	1.48	123.5	1.58
<b>RATIO ANALYSIS</b>								
<b>I. PROFITABILITY LEVEL</b>								
1. Net Income/Equity (av.)	%	6.91	6.84	4.11	4.58			
2. Net Income/Total Assets (av.)	%	2.67	2.38	1.31	1.36			
3. Net Interest Revenue + Commitment Fees/Gross Loans (av.)	%	3.68	3.34	2.79	2.73			
4. Non-int. Exp./Net Interest Rev. + Other Operating Income	%	52.12	49.64	52.02	50.67			
5. Income from Equity Investment/Equity Investment (av.)	%	n.a.	n.a.	n.a.	n.a.			
6. Provision on Loans & Equity Part./Gross Loans + Equity Investment (av.)	%	0.06	0.90	0.58	0.42			
<b>II. CAPITAL ADEQUACY</b>								
1. Internal Capital Generation	%	6.91	6.84	4.11	4.58			
2. Outstanding Loans + Equity Invest. + guarantees /Subscribed Capital + Reserves	%	24.67	27.52	29.47	37.08			
3. Capital/Risks - Tier 1 (Basle G10)	%	n.a.	n.a.	n.a.	n.a.			
4. Capital/Risks - Total (Basle G10)	%	n.a.	n.a.	n.a.	n.a.			
5. Equity/Total Assets	%	41.65	35.77	33.73	30.35			
6. AAA-AA- Callable Capital/Callable Capital	%	37.21	37.17	37.88	34.95			
7. Available Equity/Required Capital (memo)	%	685.69	613.08	609.39	422.65			
<b>III. LIQUIDITY</b>								
1. Liquid Assets & Marketable Debt Securities/Debt < 1 Year	%	416.64	144.64	277.06	296.72			
2. Liquid Assets & Marketable Debt Securities/Total Assets	%	25.41	24.88	21.62	13.92			
3. Liquid Assets + Marketable Debt Securities/Undisbursed Loans	%	123.18	103.28	98.92	56.48			
<b>IV. ASSET QUALITY</b>								
1. Non Accrual Loans /Gross Loans	%	14.27	19.89	24.67	14.45			
2. Loan Loss Provision/Gross Loans	%	8.24	7.64	6.42	5.71			
3. Allowance for Possible Loss/Equity Investment	%	9.90	10.59	7.56	6.78			
4. Loan Loss Reserves/Non Accrual Loans	%	57.75	38.43	26.02	39.47			
5. Loans to Investment Grade Borrowers/Gross Loans + Equity Investment	%	24.10	23.92	22.54	21.89			
<b>V. LEVERAGE</b>								
1. Debt/Subscribed Capital + Reserves	%	19.39	22.90	24.68	29.08			
2. Debt/Callable Capital	%	22.99	26.87	29.05	35.37			
3. Net Income + Interest Paid/Interest Paid	%	188.91	160.17	134.90	136.75			

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